

*Material for*  
*Staff Presentation to the*  
*Federal Open Market Committee*

*June 29, 1988*

## **Policy Assumptions**

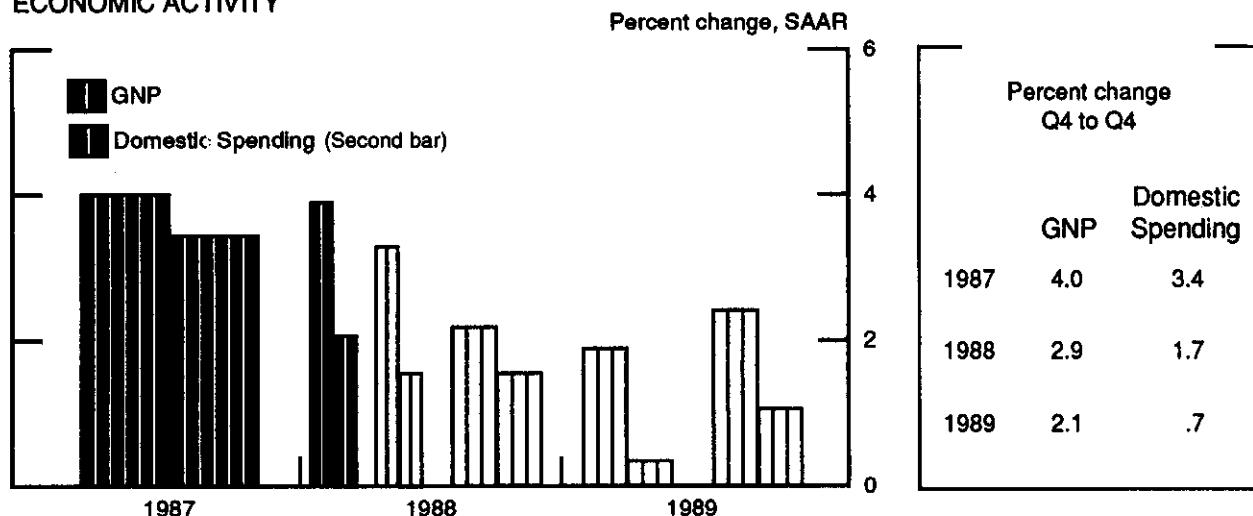
- Federal Reserve seeks to curb inflationary pressures.
- No additional steps are taken to cut the federal budget deficit through FY89.

## **Financial Conditions**

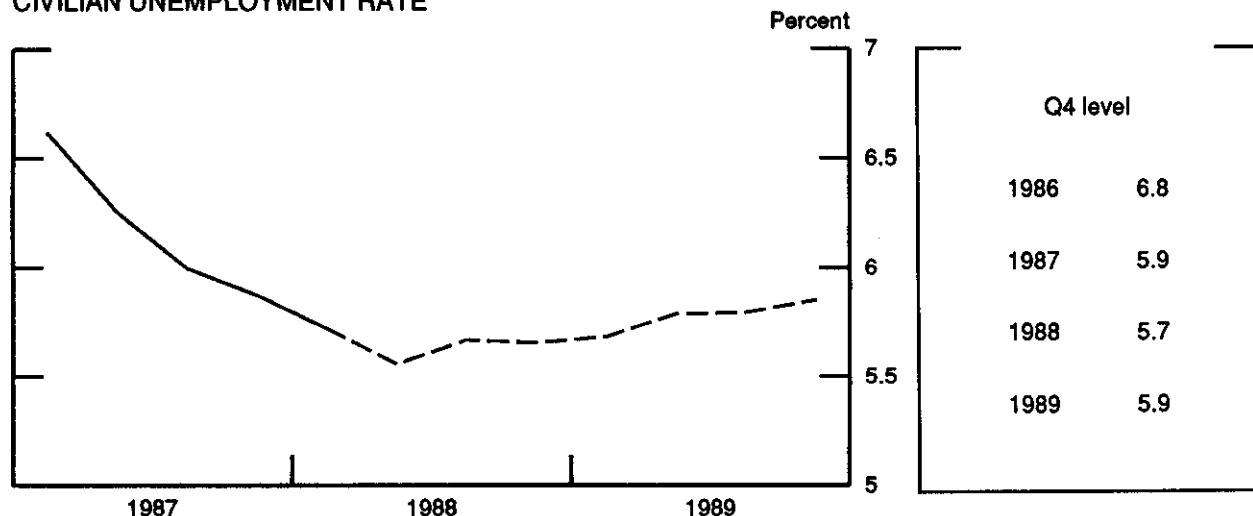
- Interest rates rise, probably by a percentage point or more between now and next spring.
- Rate increase induces a rise in monetary velocity
  - M2 grows around 6 percent in 1988 and 4 percent in 1989.
  - M3 grows faster than M2 in both years.
- The dollar depreciates moderately on balance over the projection period.

Chart 2

## ECONOMIC ACTIVITY



## CIVILIAN UNEMPLOYMENT RATE



## INFLATION

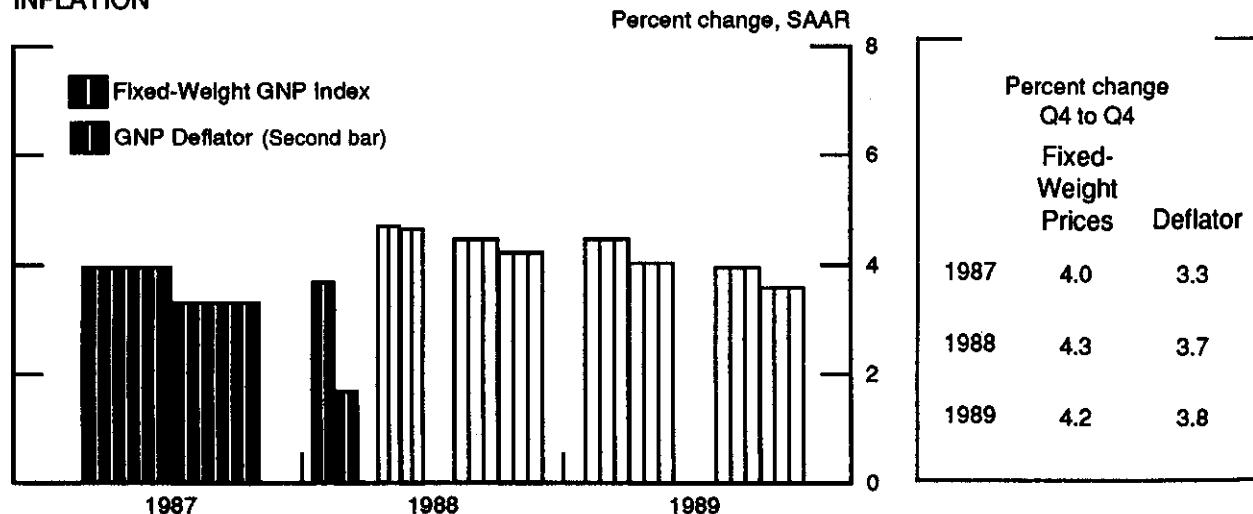
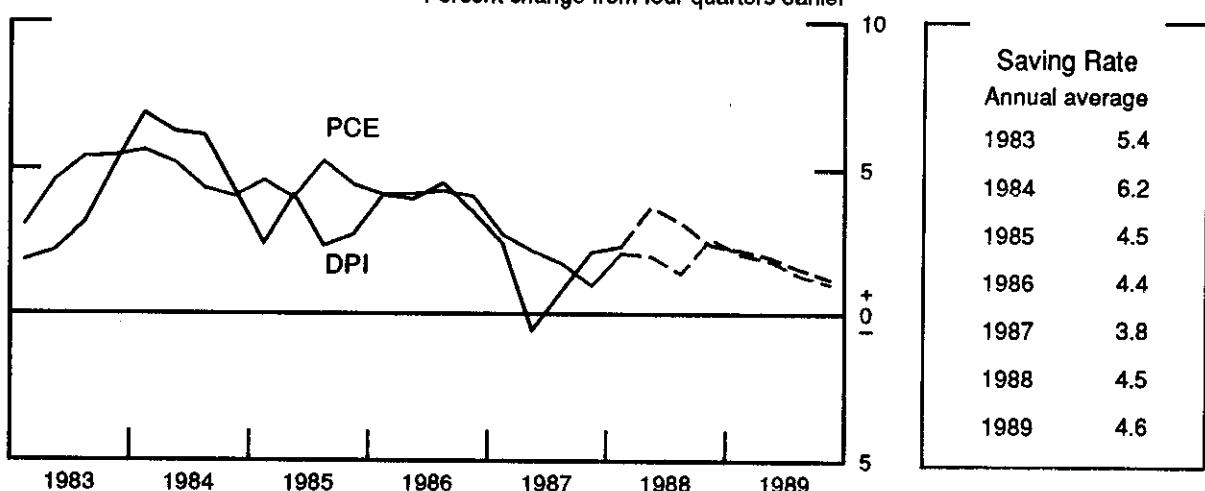
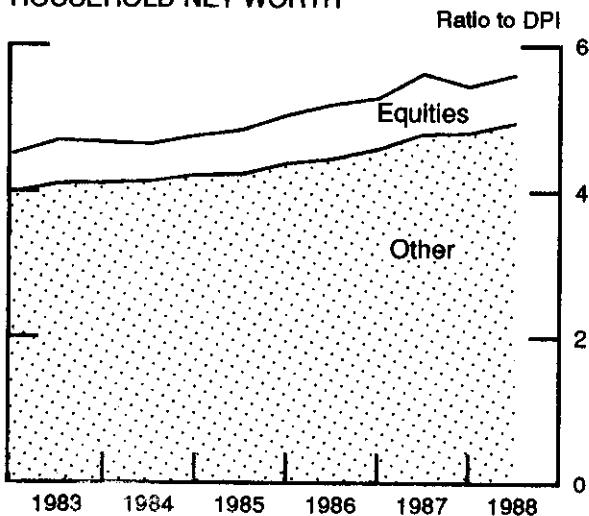


Chart 3

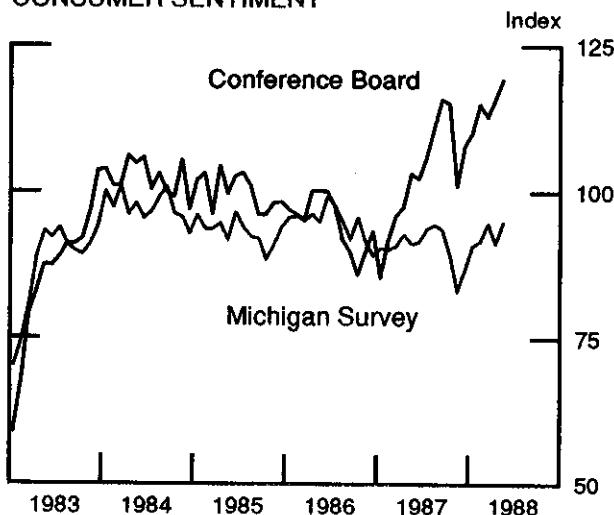
**REAL PERSONAL CONSUMPTION EXPENDITURES  
AND DISPOSABLE INCOME**  
Percent change from four quarters earlier



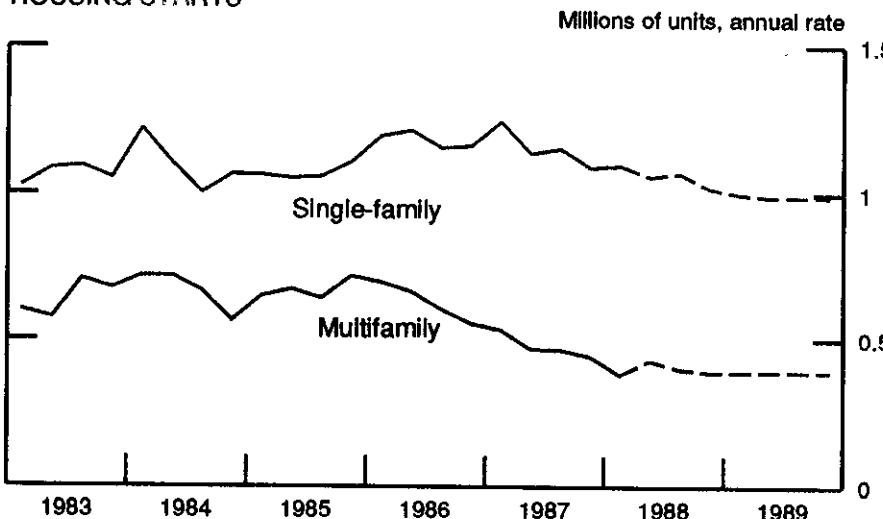
## HOUSEHOLD NET WORTH



## CONSUMER SENTIMENT



## HOUSING STARTS

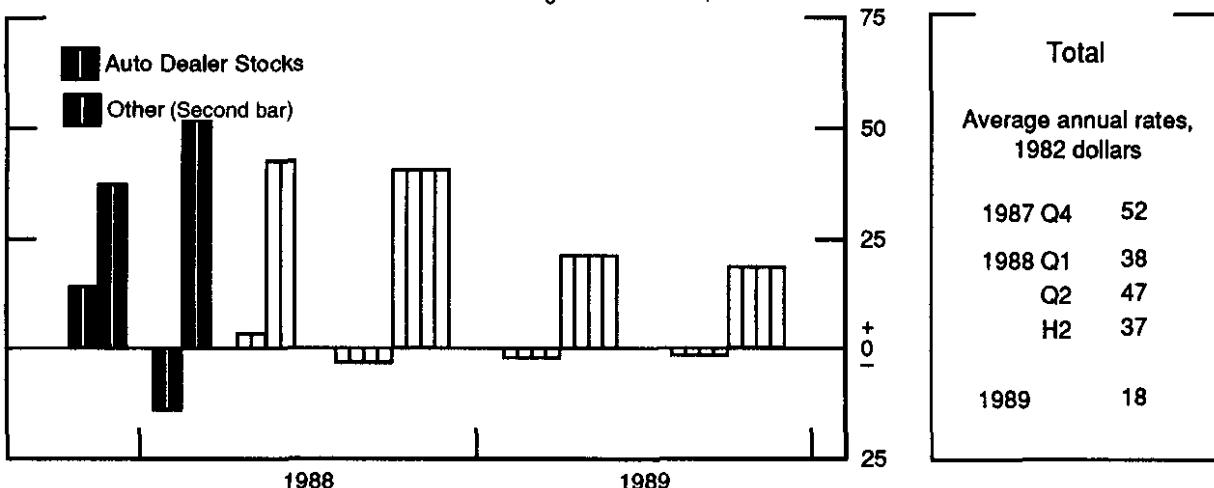
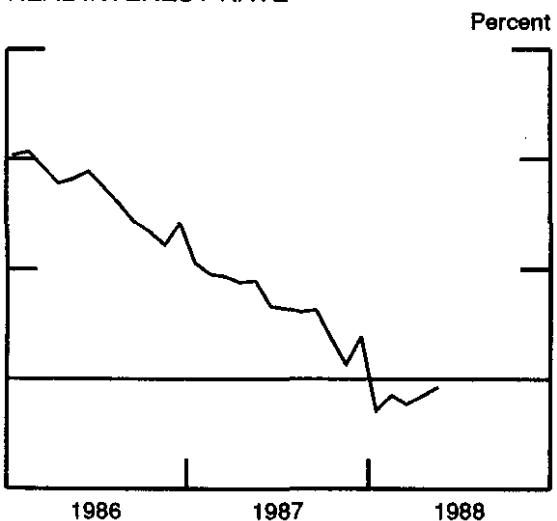
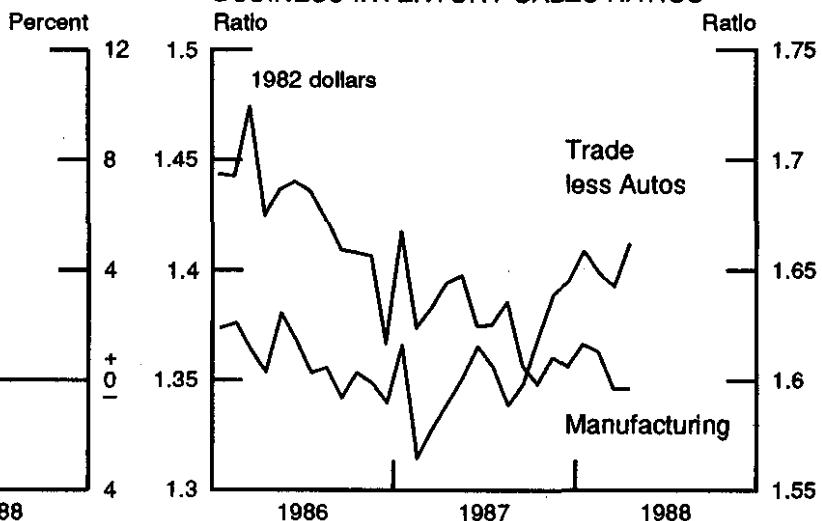


Total Starts Millions of units, annual rate	
1983	1.71
1984	1.77
1985	1.74
1986	1.81
1987	1.63
1988	1.46
1989	1.38

Chart 4

**NONFARM INVENTORY INVESTMENT**

Average annual rates, 1982 dollars

**REAL INTEREST RATE \*****BUSINESS INVENTORY-SALES RATIOS**

\* 90 day paper rate minus prior 6-month inflation rate for  
PPI intermediate goods excluding food and energy.

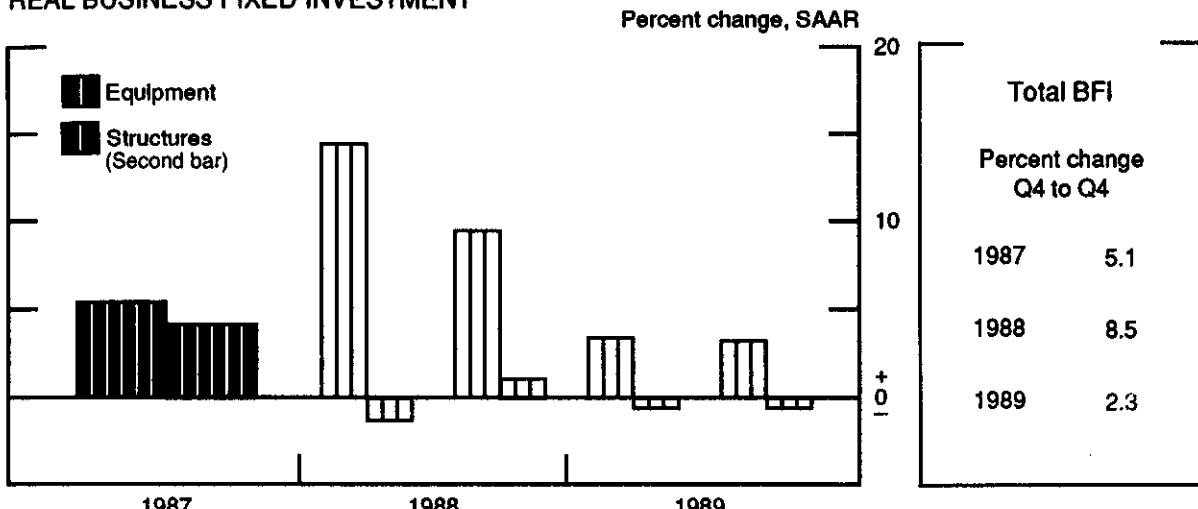
**RECENT INCREASES IN NONFARM BUSINESS INVENTORIES**

September 1987 to April 1988 — Current Cost Data

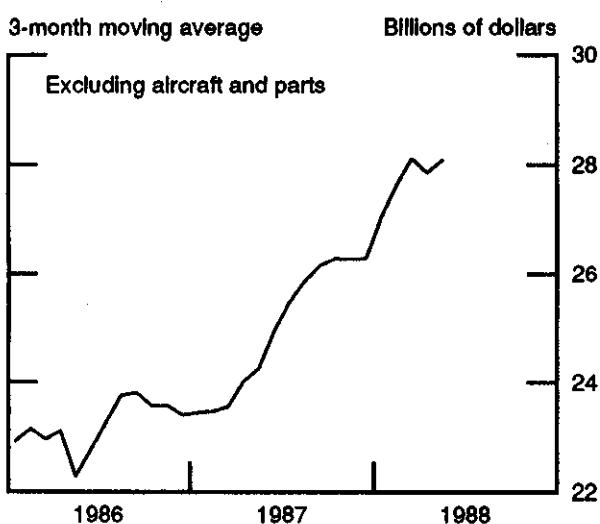
	In billions of dollars	In percent
<b>Total excluding retail auto</b>	<b>61</b>	<b>5.3</b>
Manufacturing	24	4.4
Industrial materials, nondefense capital goods	14	6.0
Wholesale	24	8.9
Machinery and metals	10	13.8
Retail	13	4.6
Apparel	0	0.0
General merchandise, appliances, furniture	6	4.9

Chart 5

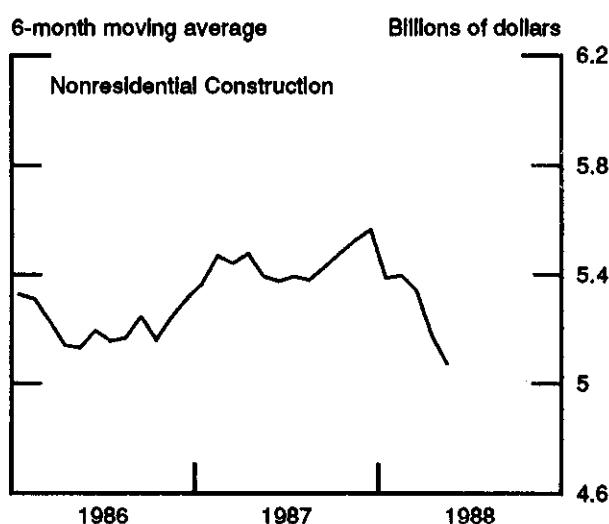
## REAL BUSINESS FIXED INVESTMENT



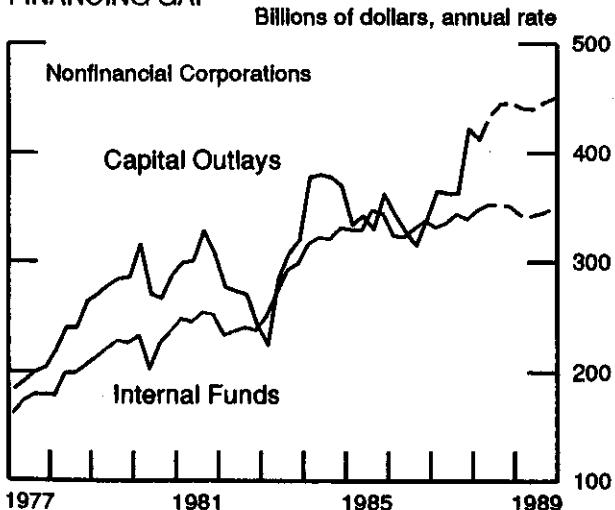
## NONDEFENSE CAPITAL GOODS ORDERS



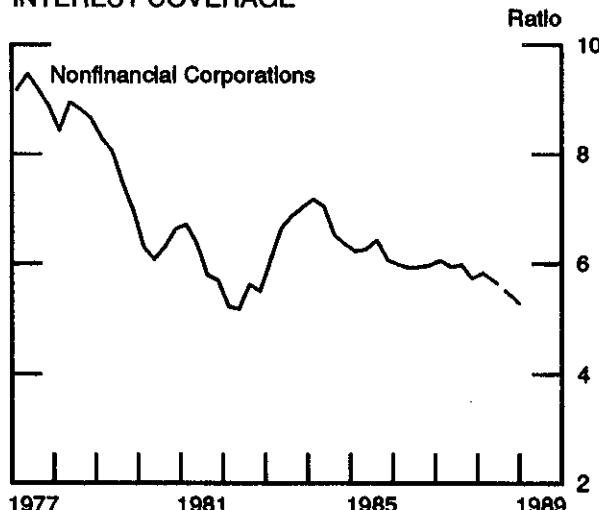
## CONTRACTS



## FINANCING GAP



## INTEREST COVERAGE \*



\* Gross pretax cash flow and net interest divided by net interest.

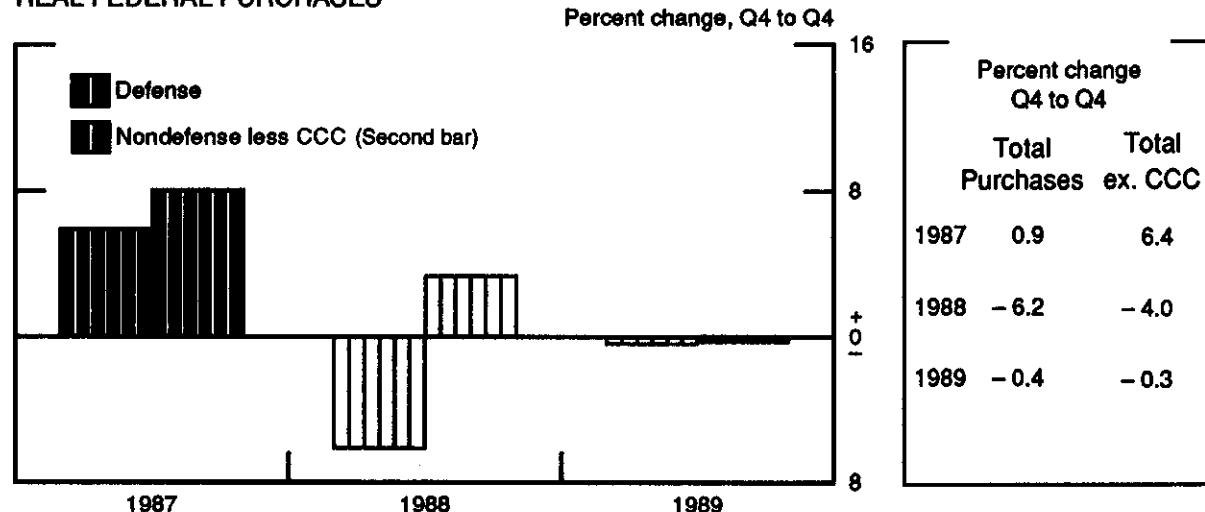
Chart 6

## FEDERAL BUDGET DEFICIT

Billions of dollars

Fiscal Year	Greenbook Forecast	Gramm-Rudman Target	Trigger
1988	158	144	n.a.
1989	157	136	146

## REAL FEDERAL PURCHASES



## REAL STATE AND LOCAL PURCHASES

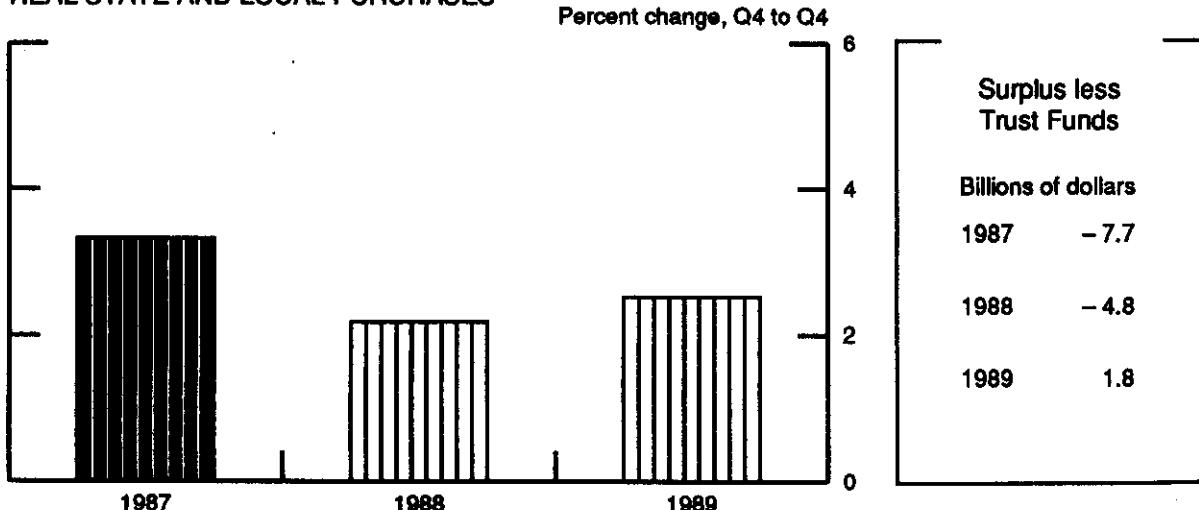
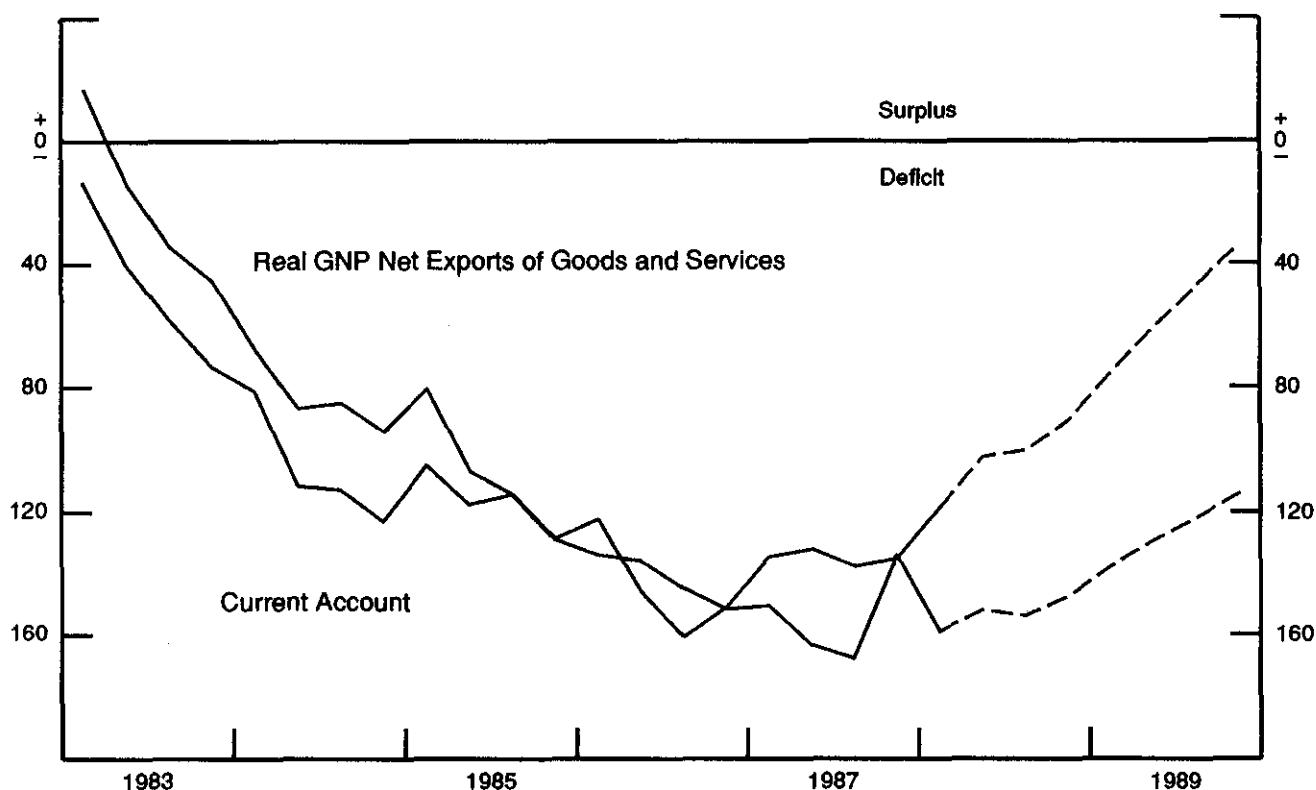


Chart 7

**EXTERNAL BALANCES**

Billions of 1982 dollars

Billions of dollars

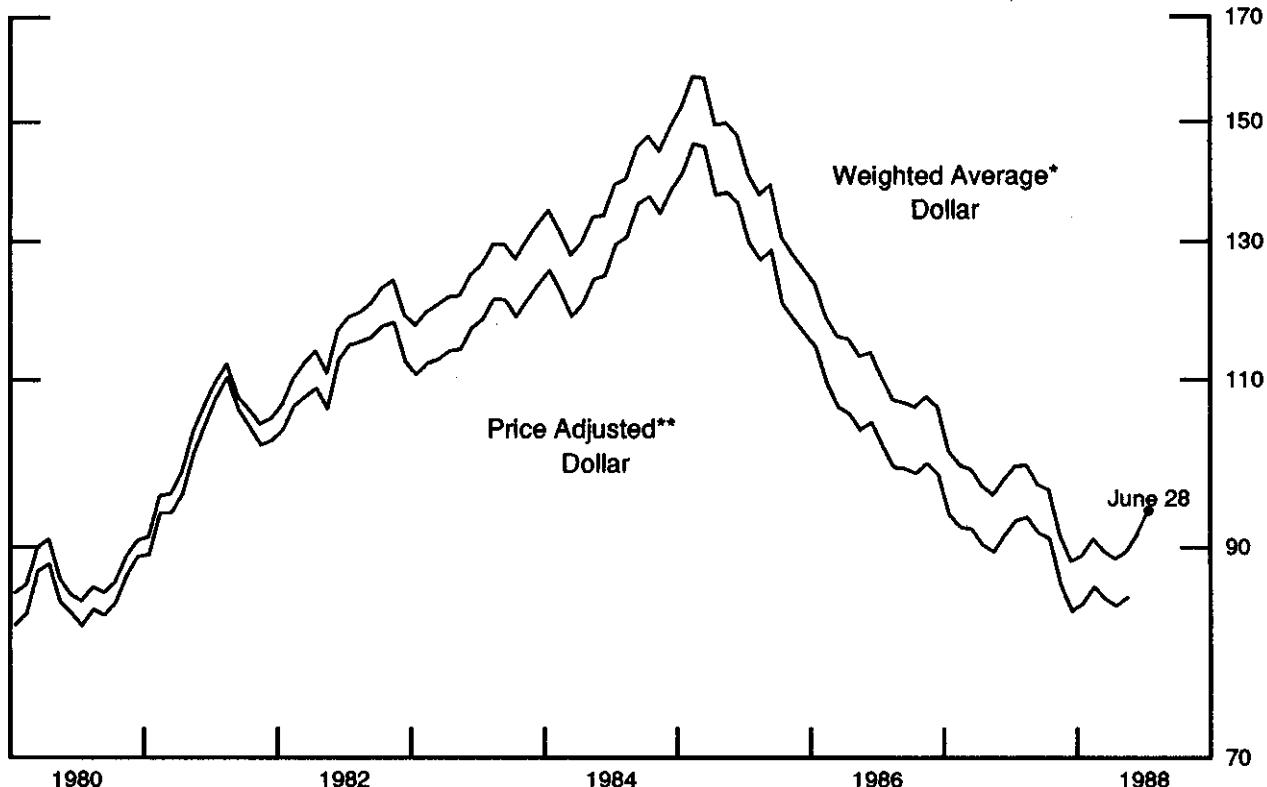
**Components of Real Net Exports of Goods and Services**  
Percent change, Q4/Q4

	1986	1987	1988	1989
Exports of Goods and Services	6	17	14	16
Goods	10	18	17	18
Services	-2	14	8	14
Imports of Goods and Services	9	9	3	5
Goods	11	7	2	3
Services	1	19	7	10

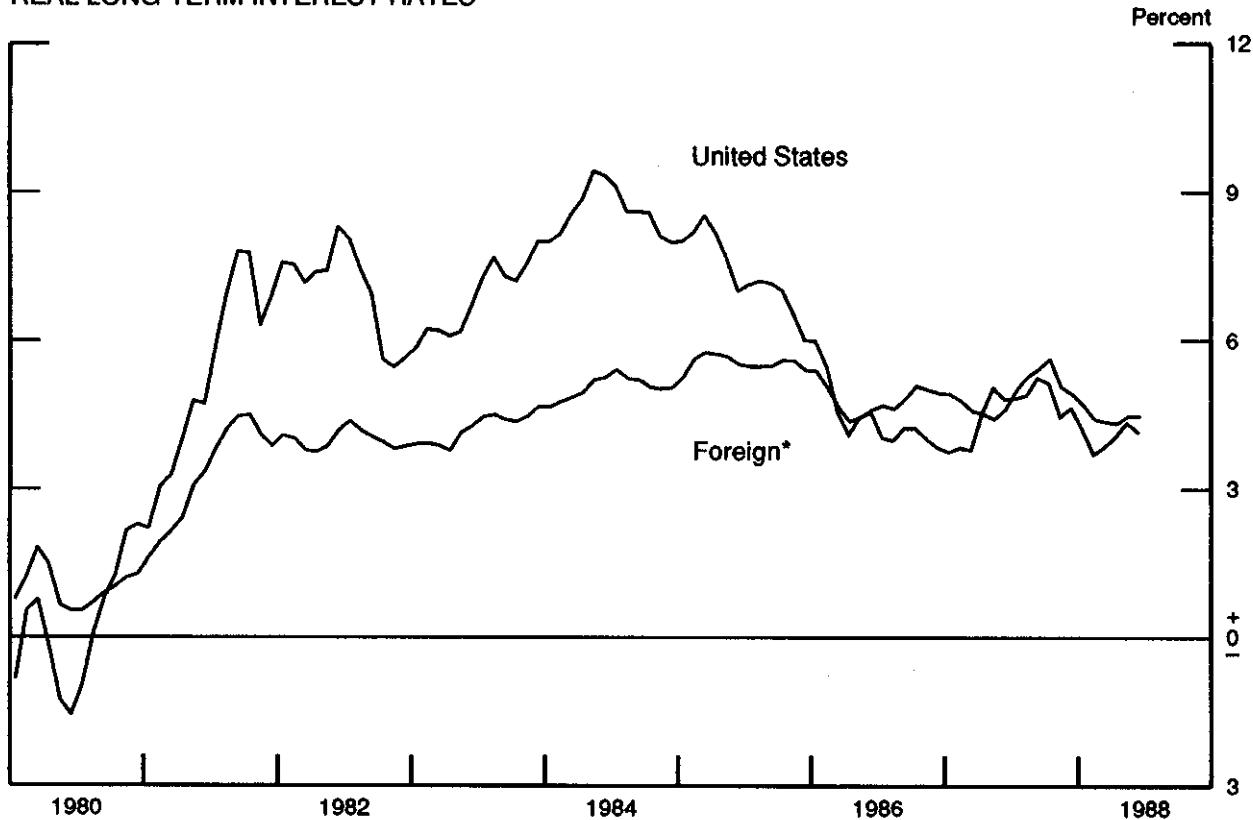
Chart 8

## FOREIGN EXCHANGE VALUE OF THE U.S. DOLLAR

Ratio scale, March 1973 = 100



## REAL LONG-TERM INTEREST RATES\*\*\*



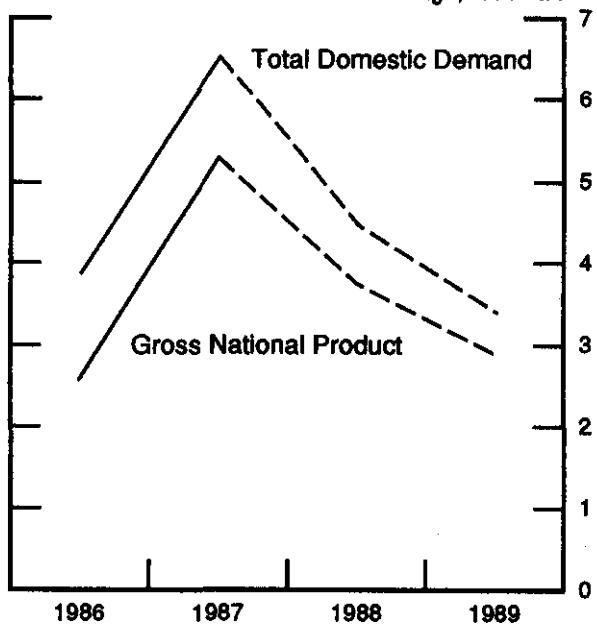
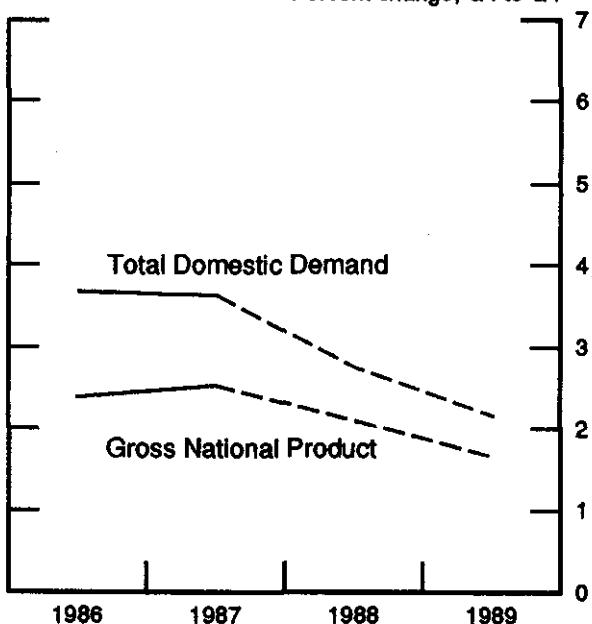
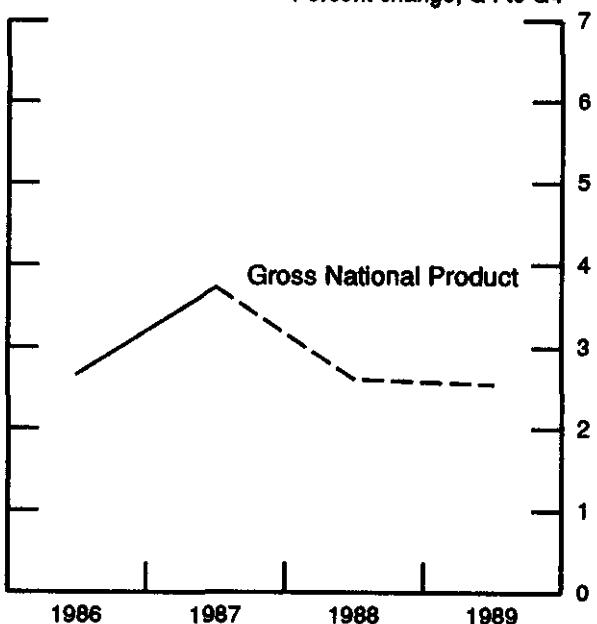
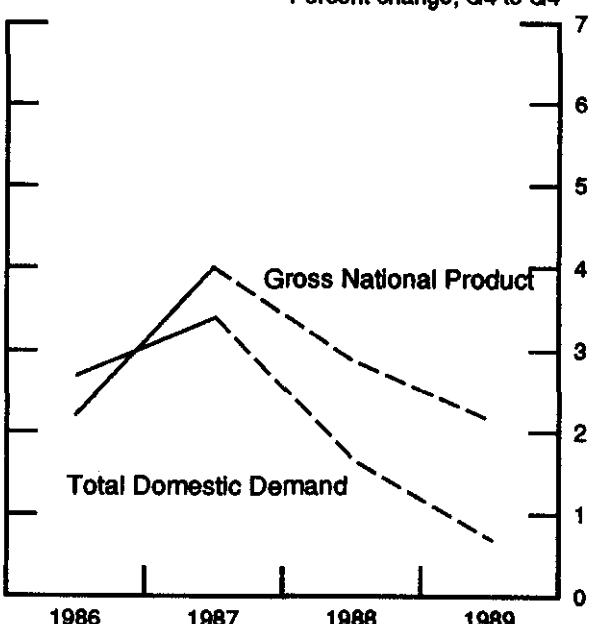
\* Weighted average against or of foreign G-10 countries using total 1972-76 average trade.

\*\* Adjusted by relative consumer prices.

\*\*\* Multilateral trade-weighted average of long-term government or public authority bond rates adjusted for expected inflation estimated by a 36-month centered moving average of actual inflation (staff forecasts where needed).

Chart 9

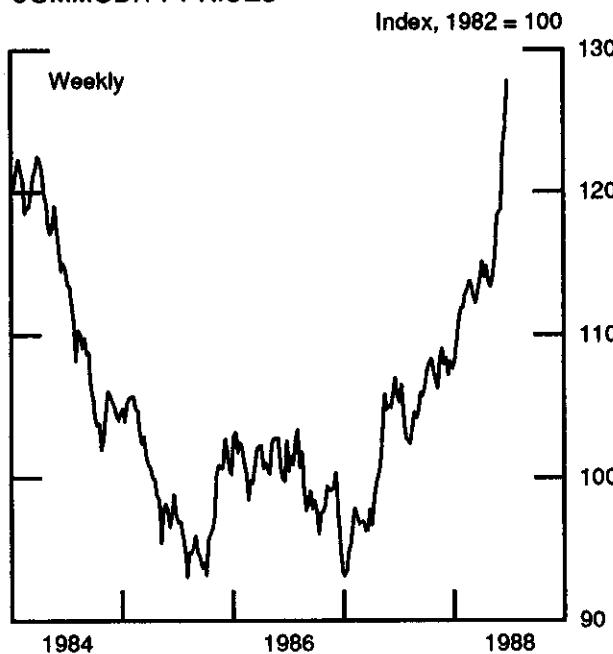
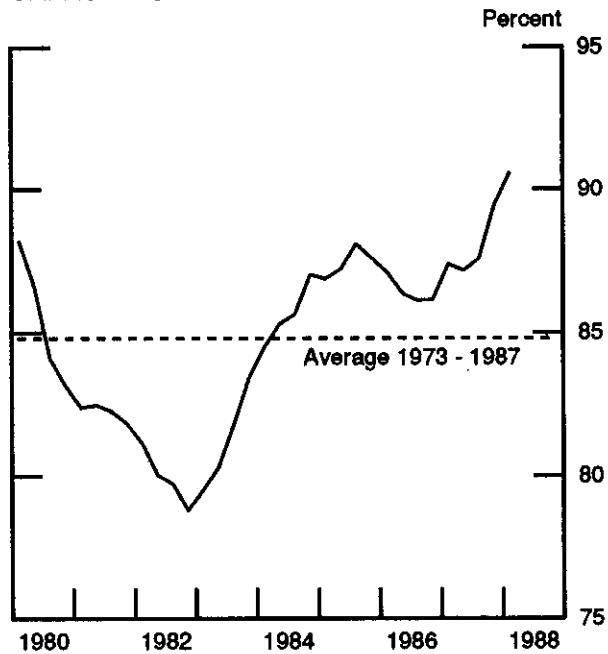
## Economic Activity

CANADA, JAPAN, AND UNITED KINGDOM \*  
Percent change, Q4 to Q4FRANCE, GERMANY, AND ITALY \*  
Percent change, Q4 to Q4ALL FOREIGN COUNTRIES \*\*  
Percent change, Q4 to Q4UNITED STATES  
Percent change, Q4 to Q4

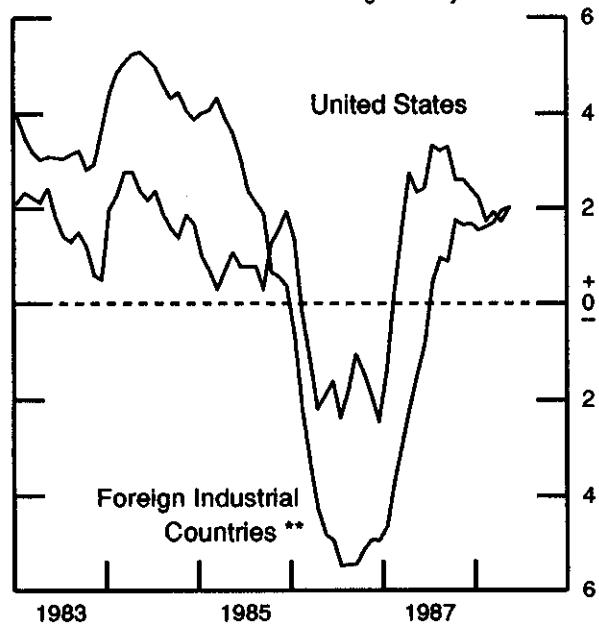
\* Weighted average using 1982 GNP.

\*\* Weighted average using 1978-83 U.S. non-agricultural exports.

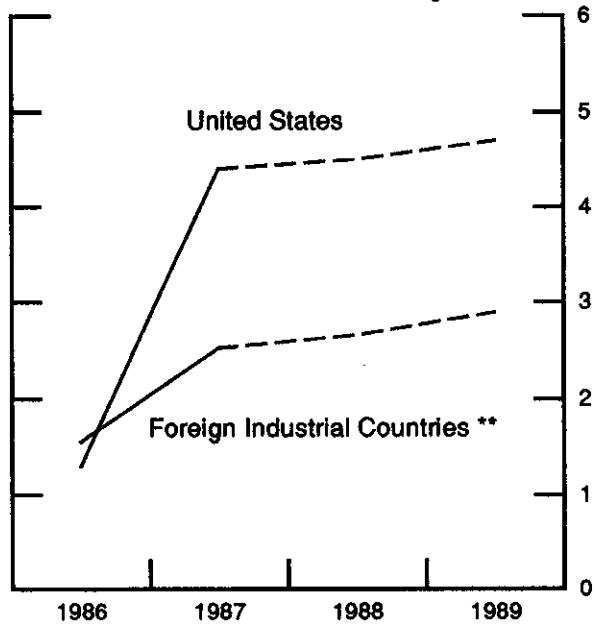
Chart 10

**COMMODITY PRICES \*****CAPACITY UTILIZATION ABROAD \*\*****WHOLESALE PRICES**

Percent change from year earlier

**CONSUMER PRICES**

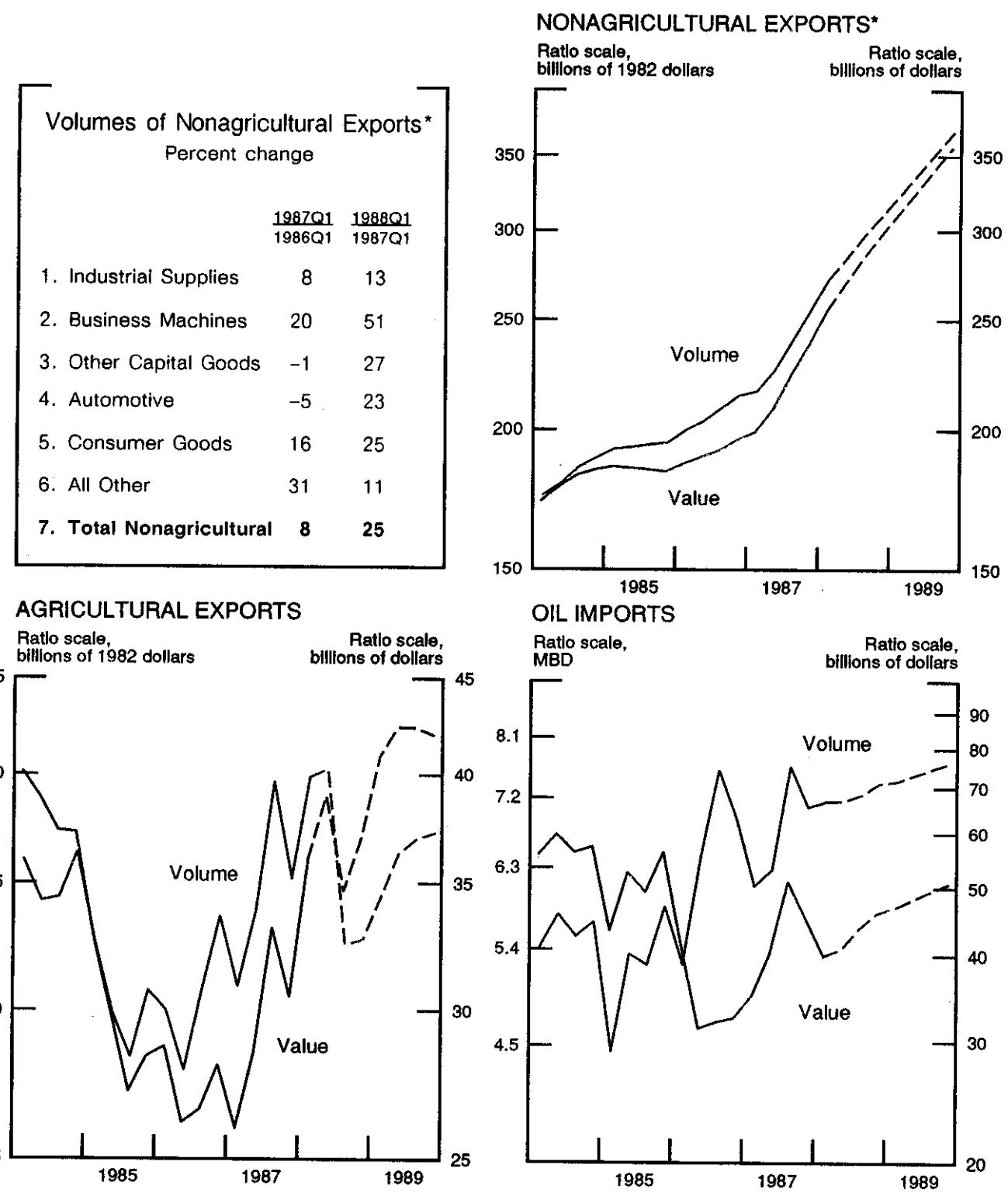
Percent change, Q4 to Q4



\* FRB experimental price index excluding crude oil.

\*\* Weighted average for the six major foreign industrial countries using 1982 GNP.

Chart 11



\* Excluding gold.

Chart 12

**Prices of Non-oil Imports**

Percent change

	1987Q1 1986Q1	1988Q1 1987Q1
--	------------------	------------------

1. Food	-1	6
2. Industrial Supplies	0	17
3. Business Machines	-4	-9
4. Other Capital Goods	13	8
5. Automotive	8	6
6. Consumer Goods	8	9
7. Total Non-oil	6	9

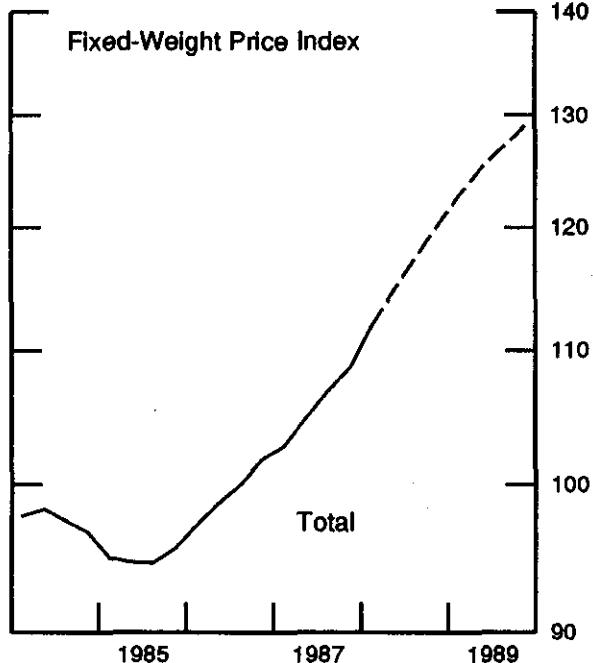
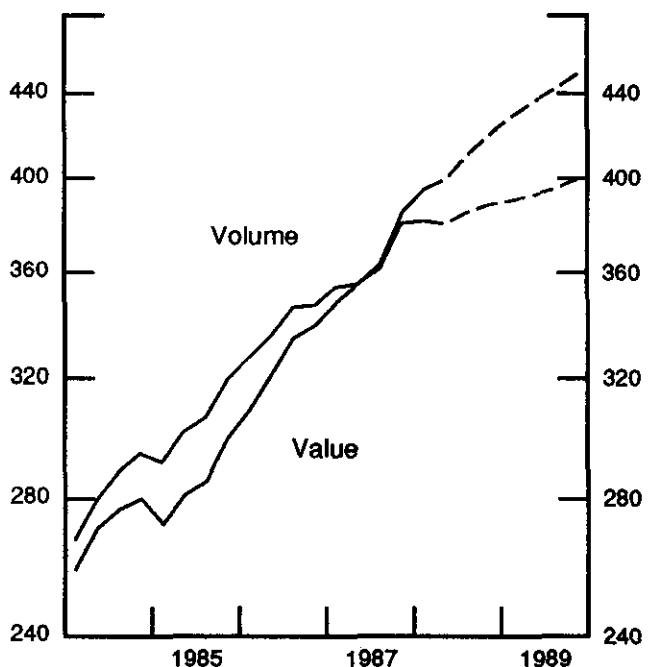
NIPA fixed-weight indexes

**Volumes of Non-oil Imports\***

Percent change

	1987Q1 1986Q1	1988Q1 1987Q1
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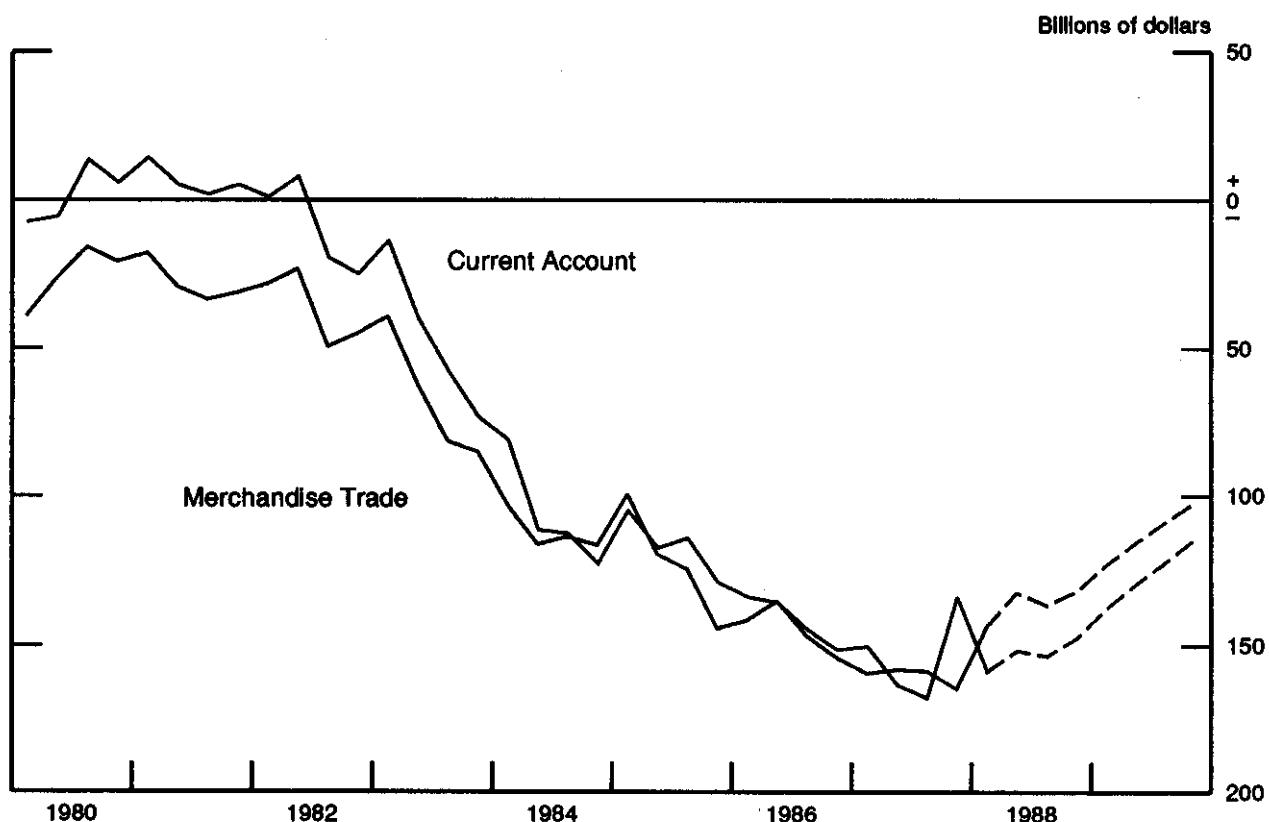
1. Food	0	2
2. Industrial Supplies	5	1
3. Business Machines	31	47
4. Other Capital Goods	1	16
5. Automotive	7	-1
6. Consumer Goods	-3	1
7. Total Non-oil	8	7

**PRICE OF NON-OIL IMPORTS**Ratio scale,  
Index, 1982 = 100**NON-OIL IMPORTS\***Ratio scale,  
billions of 1982 dollarsRatio scale,  
billions of dollars

\* Excluding gold.

Chart 13

EXTERNAL BALANCES



U.S. INTERNATIONAL INVESTMENT POSITION

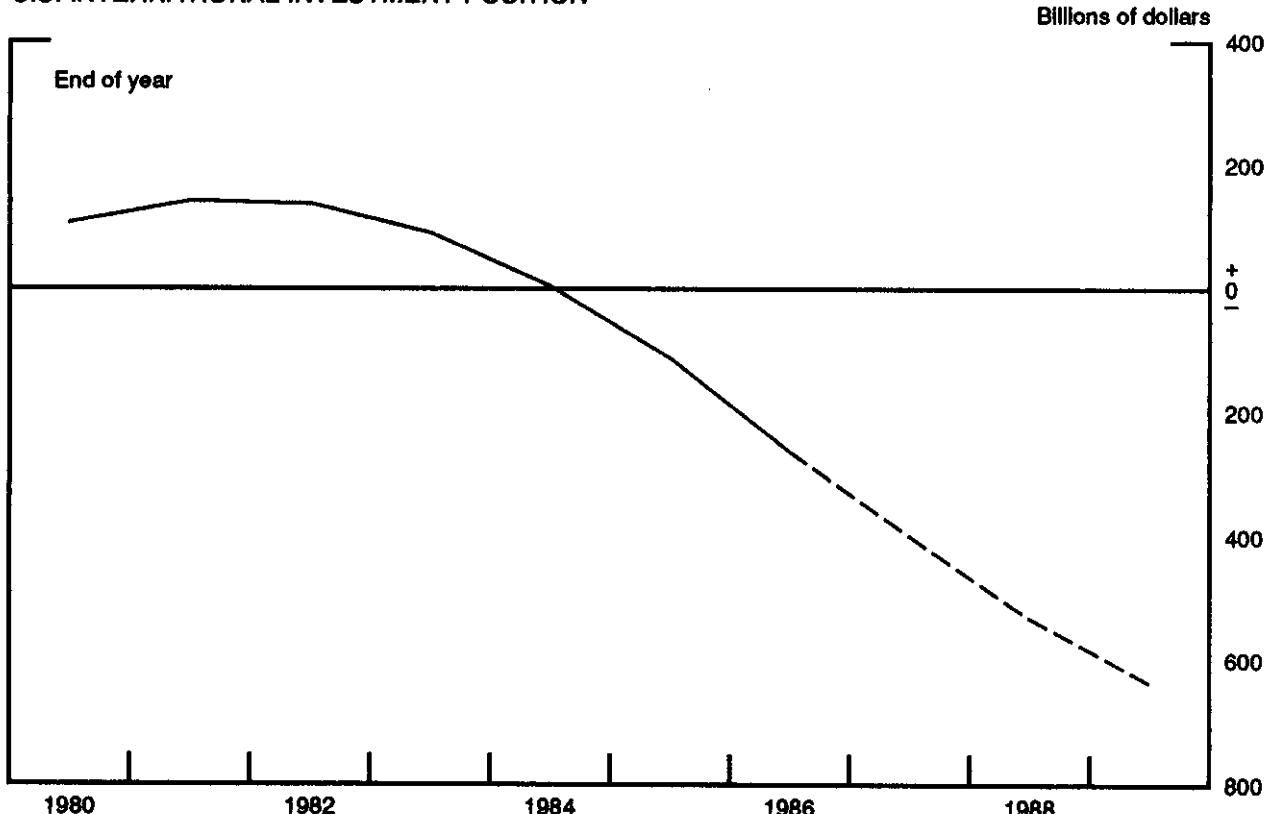
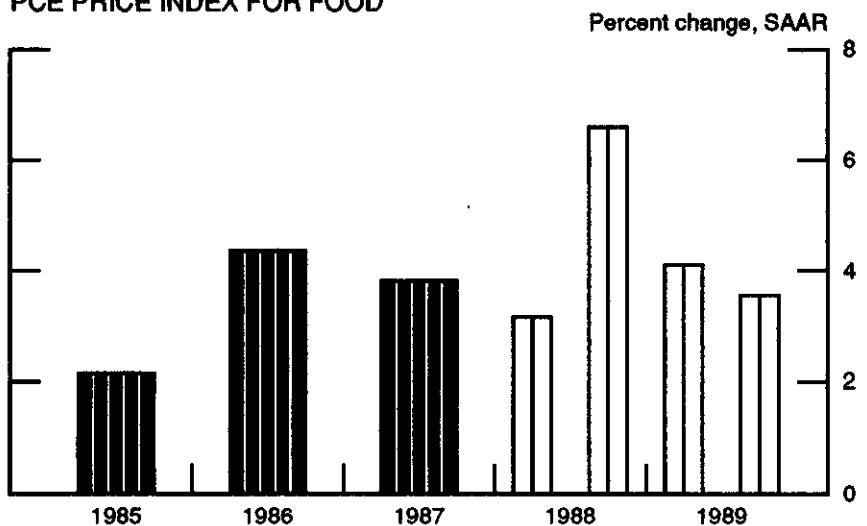
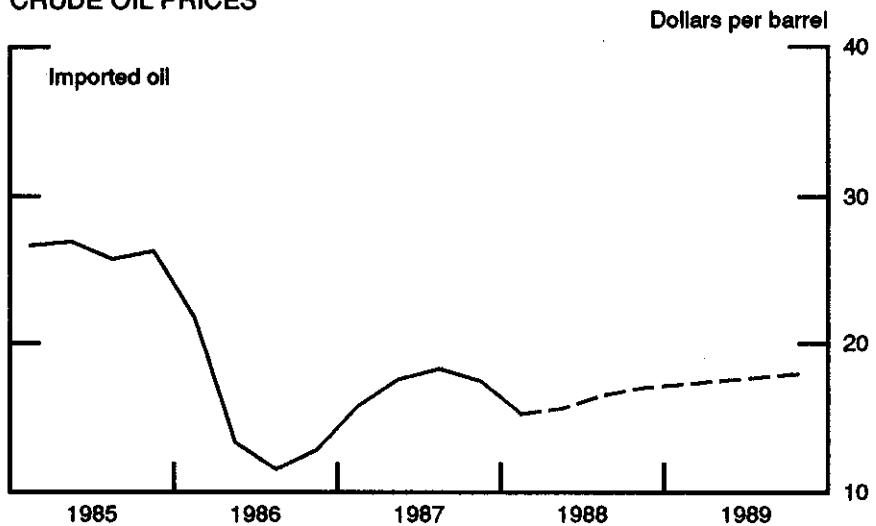


Chart 14

PCE PRICE INDEX FOR FOOD



CRUDE OIL PRICES



PRICE OF NONOIL IMPORTS EXCLUDING BUSINESS MACHINES

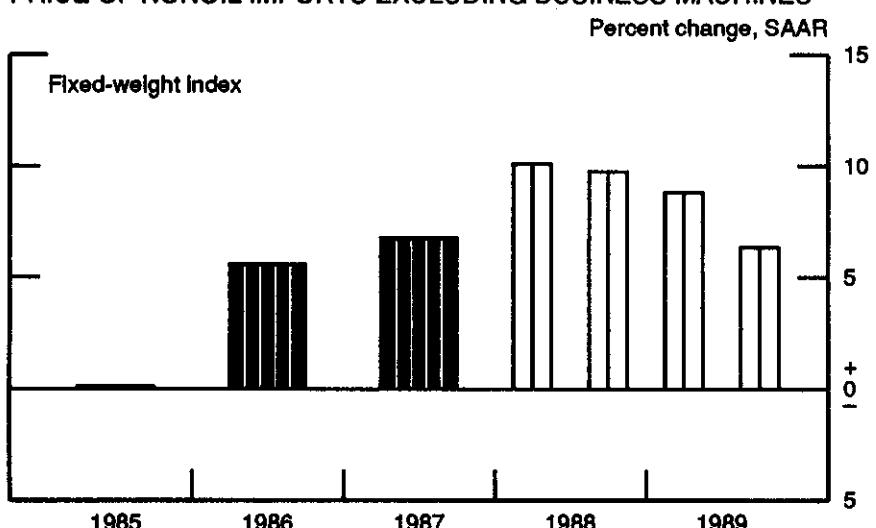
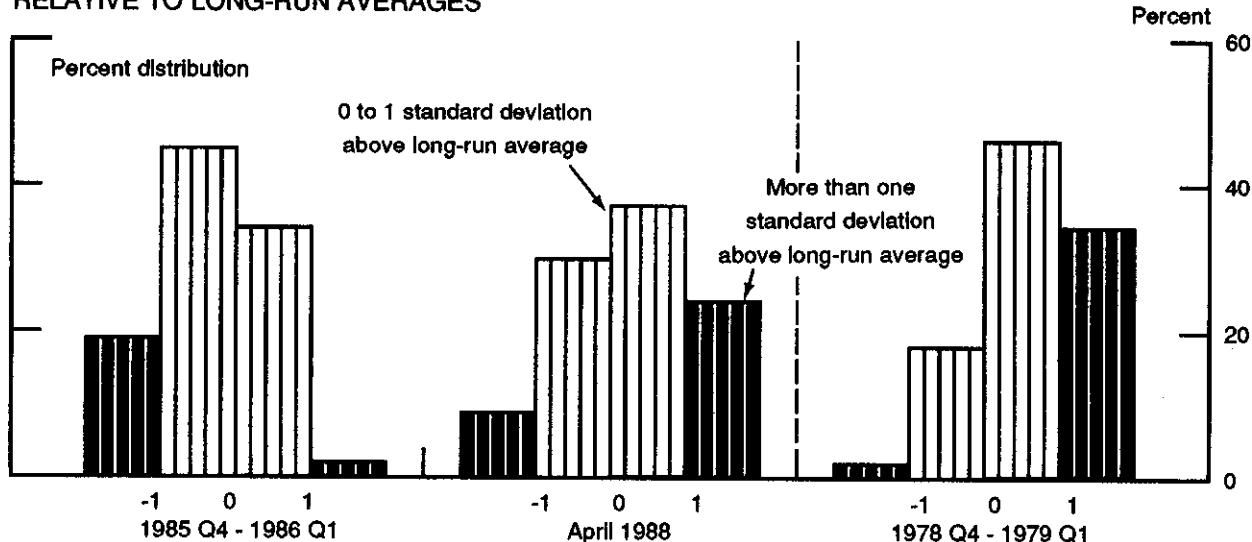
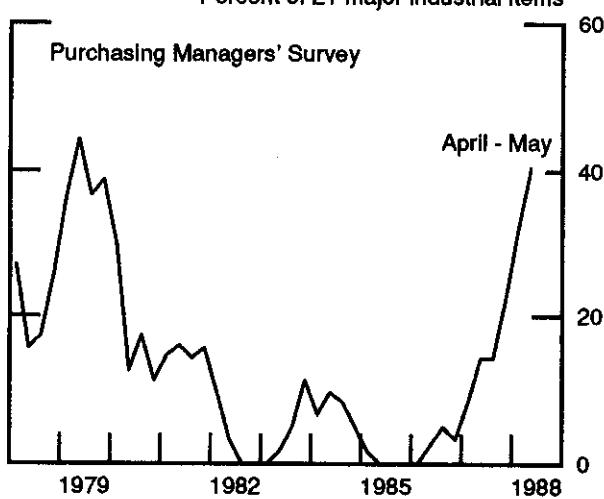


Chart 15

**UTILIZATION RATES IN NONENERGY MATERIALS INDUSTRIES  
RELATIVE TO LONG-RUN AVERAGES**



**INDUSTRIAL MATERIALS IN SHORT SUPPLY**  
Percent of 21 major Industrial Items



**ORDER LEAD TIMES FOR PRODUCTION MATERIALS**



**CAPACITY UTILIZATION RATE -- ADVANCED PROCESSING INDUSTRIES**

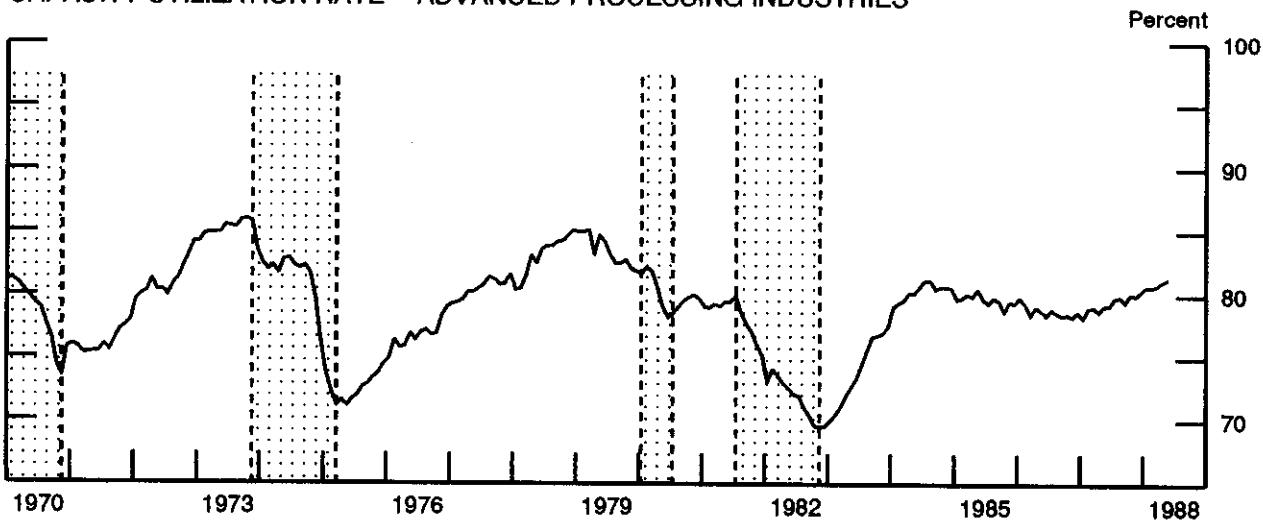
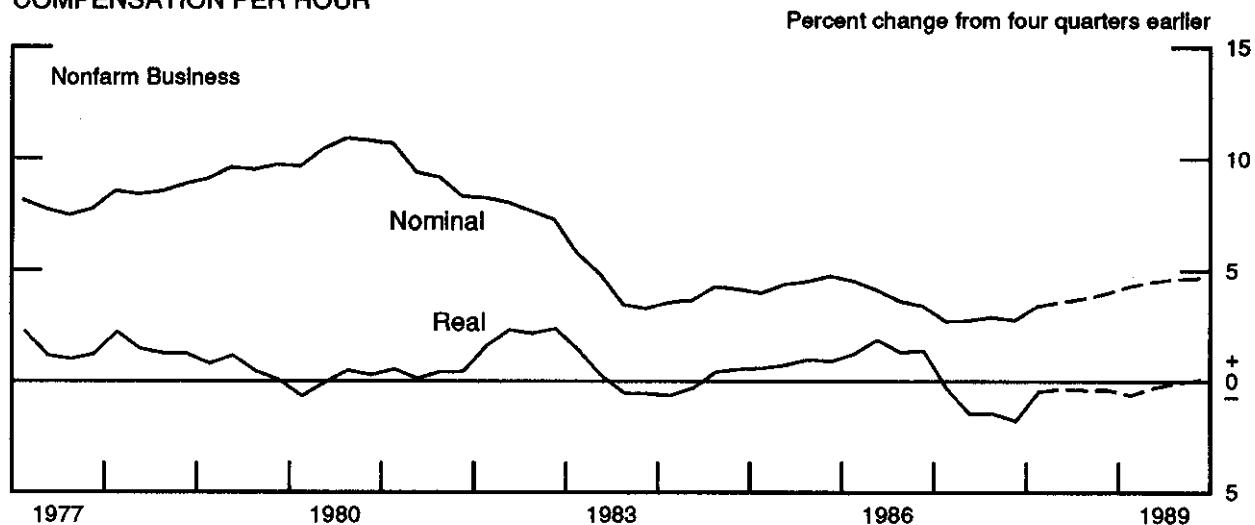
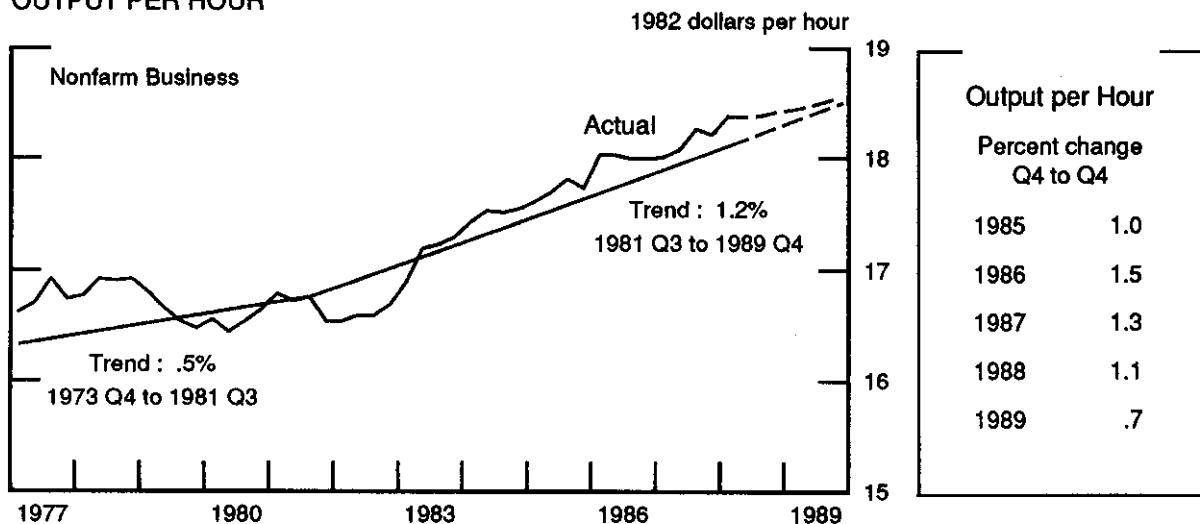


Chart 16

## COMPENSATION PER HOUR



## OUTPUT PER HOUR



## LABOR COSTS AND PRICES

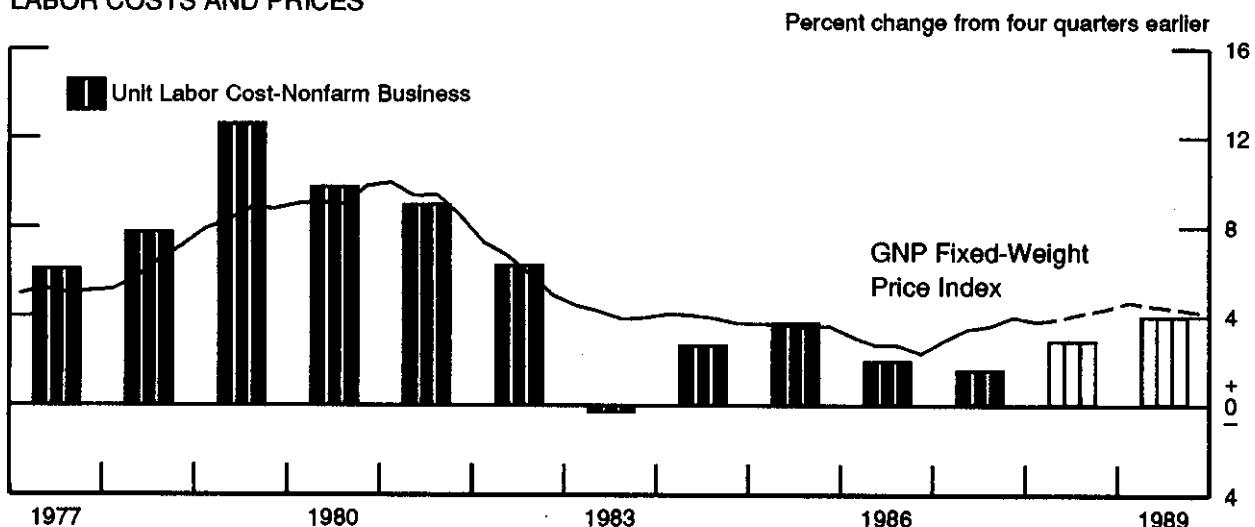


Chart 17

## ALTERNATIVE PROJECTIONS

		1988	1989	1990
Real GNP	<i>Baseline</i>	2.9	2.1	2.2
Percent change, Q4 to Q4	<i>Stable Rates</i>	3.0	3.0	3.6
GNP Prices	<i>Baseline</i>	4.3	4.2	3.8
Percent change, Q4 to Q4	<i>Stable Rates</i>	4.3	4.3	4.4
Unemployment	<i>Baseline</i>	5.7	5.9	6.0
Percent, Q4	<i>Stable Rates</i>	5.7	5.5	5.1

## FORECAST SUMMARY

		FOMC	Administration	Staff
	Range	Central Tendency		
Percent change, Q4 to Q4				
Nominal GNP				
1988	4 to 7	6 to $6\frac{1}{2}$	6.6	6.7
1989	4 to $7\frac{1}{4}$	$5\frac{3}{4}$ to $6\frac{1}{2}$	7.1	6.0
Real GNP				
1988	1 to $3\frac{1}{2}$	$2\frac{3}{4}$ to 3	3.0	2.9
1989	1 to 3	2 to $2\frac{1}{4}$	3.3	2.1
GNP Deflator				
1988	$2\frac{3}{4}$ to 4	3 to $3\frac{1}{2}$	3.5	3.7
1989	2 to 5	$3\frac{1}{2}$ to 4	3.7	3.8
Average level, Q4, percent				
Unemployment Rate				
1988	$5\frac{1}{4}$ to $6\frac{1}{2}$	$5\frac{1}{2}$	5.5	5.7
1989	5 to 7	$5\frac{3}{4}$ to 6	5.3	5.9